MAR 29 19
MICHAEL RODAK, JR

Nos. 73-437, 73-457, 73-464

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-437

MOBIL OIL CORPORATION,

v. *Petitioner*

FEDERAL POWER COMMISSION

No. 73-457

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,

v. *Petitioner*

FEDERAL POWER COMMISSION

No. 73-464

MUNICIPAL DISTRIBUTORS GROUP,

v. *Petitioner*

FEDERAL POWER COMMISSION

On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF RESPONDENT THE CALIFORNIA COMPANY, A DIVISION OF CHEVRON OIL COMPANY

Of Counsel:

PILLSBURY, MADISON & SUTRO
225 Bush Street
San Francisco, Calif. 94104

WOLF & CASE
1625 K St., N.W.
Washington, D.C. 20006

FRANCIS R. KIRKHAM
JAMES B. ATKIN
225 Bush Street
San Francisco, Calif. 94104

WOOLLEN H. WALSHE
1111 Tulane Avenue
New Orleans, Louisiana 70112

JUSTIN R. WOLF
DAVID B. WARD
1625 K St., N.W.
Washington, D.C. 20006

March 29, 1974

INDEX

	Page
QUESTION PRESENTED	2
STATEMENT OF THE CASE	3
ARGUMENT	11
1. MDG's contention that the Commission was without power to reopen the case	15
2. Petitioners' contentions that the $150,000,000 refund is not supported by substantial evidence	16
3. Petitioners' contentions that the rates fixed by the Commission for flowing gas and new gas are unsupported by substantial evidence	18
4. Petitioners' contentions that the rates fixed by the Commission are unduly discriminatory	22
A. The incentive provisions in the refund order	22
B. The incentive provisions in the rate structure	26
5. Mobil's contentions as to royalties and moratoria	27
6. Casinghead gas	27
7. Pipeline transportation	28
CONCLUSION	29

TABLE OF AUTHORITIES

CASES	Page
Amoco Production Company v. *Federal Power Commission*, 465 F.2d 1350 (10th Cir. 1972)	13
Cities of Lexington, etc., Ky. v. *Federal Power Commission*, 295 F.2d 109 (4th Cir. 1961)	13
Colorado Interstate Gas Company v. *Federal Power Commission*, 324 U.S. 581 (1945)	20
Federal Power Commission v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972)	3
Ford Motor Company v. *National Labor Relations Board*, 305 U.S. 364 (1939)	16
In re Hugoton-Anadarko Area Rate Case, 466 F.2d 974 (9th Cir. 1972)	13, 17
Hunt Oil Company v. *Federal Power Commission*, 334 F.2d 474 (5th Cir. 1964)	16
Mobil Oil Corporation v. *Federal Power Commission*, 483 F.2d 1238 (D.C. Cir. 1973)	28
Natural Gas Pipeline Company of America v. *Federal Power Commission*, 128 F.2d 481 (7th Cir. 1942)	16
Pennsylvania Gas & Water Company v. *Federal Power Commission*, 463 F.2d 1242 (D.C. Cir. 1972)	13
Permian Basin Area Rate Cases, 390 U.S. 747 (1968)	*passim*
Phillips Petroleum Company v. *Wisconsin*, 347 U.S. 672 (1954)	15
Public Service Commission for the State of New York v. *Federal Power Commission*, 487 F.2d 1043 (D.C. Cir. 1973)	22
Securities and Exchange Commission v. *Chenery Corporation*, 332 U.S. 194 (1947)	16
Southern Louisiana Area Rate Cases (*Austral Oil Company* v. *Federal Power Commission*), 428 F.2d 407, on rehearing 444 F.2d 125 (5th Cir. 1970), *certiorari denied sub nom., Municipal Distributors Group* v. *Federal Power Commission*, 400 U.S. 950 (1970)	3, 4, 5

TABLE OF AUTHORITIES—Continued

	Page
United Gas Improvement Company v. *Callery Properties, Inc.*, 382 U.S. 223 (1965)	16
Wisconsin v. *Federal Power Commission*, 373 U.S. 294 (1963)	17

ADMINISTRATIVE DECISIONS

Area Rate Proceeding (Permian Basin Area II), 50 F.P.C. ——, Opinion No. 662, Docket No. AR70-1 (Phase I), issued August 7, 1973	14
Area Rate Proceedings (Southern Louisiana Area), 25 F.P.C. 942 (1961); 40 F.P.C. 530 (1968); 41 F.P.C. 301 (1969); 41 F.P.C. 378 (1969); 42 F.P.C. 1110 (1969); 44 F.P.C. 1638 (1970)	3, 5
Socony Mobil Oil Company, Inc., 31 F.P.C. 1101 (1964)	23, 24

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-437

MOBIL OIL CORPORATION,
Petitioner

v.

FEDERAL POWER COMMISSION

No. 73-457

PUBLIC SERVICE COMMISSION OF
THE STATE OF NEW YORK,
Petitioner

v.

FEDERAL POWER COMMISSION

No. 73-464

MUNICIPAL DISTRIBUTORS GROUP,
Petitioner

v.

FEDERAL POWER COMMISSION

On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF OF RESPONDENT THE CALIFORNIA COMPANY, A DIVISION OF CHEVRON OIL COMPANY

QUESTION PRESENTED

These proceedings commenced in 1961 with the institution by the Federal Power Commission of the *Southern Louisiana Area Rate Case* to establish just and reasonable rates for producer gas sales in the Southern Louisiana area. More than 34,000 pages of testimony and 272 exhibits were received. In 1968 the Commission issued its first decision. On appeal, the court below "affirmed" but specifically fashioned its judgment to authorize the Commission to reopen the case, to consider the effect of the rates fixed by the Commission upon the critical gas shortage and to establish substitute rates, both past and prospective, if the Commission found this to be in accord with the evidence and in the public interest. Petitions for writs of certiorari to review this decision of the Fifth Circuit were denied by this court at 400 U.S. 950. Thereafter, the Commission reopened the proceedings, consolidated them with a new proceeding commenced in 1969, received 7800 pages of additional testimony and 111 new exhibits, and, finally, in July 1971 issued its decision establishing rates for the area, both past and present. These rates included "incentive provisions" permitting producers to work-off refund obligations by contributing new gas to the interstate market and allowing increases of up to 1½ cents per Mcf if, prior to October 1, 1977, the industry finds and dedicates to the interstate market new gas reserves of 15 trillion cubic feet. On appeal, the court below pointed out that the Commission's decision was clearly within its authority under the Natural Gas Act as construed by this Court in *Permian* (390 U.S. 747) and held that the decision was supported by substantial evidence.

The question presented is whether the court below correctly held that the Commission's decision is supported by substantial evidence.

STATEMENT OF THE CASE

These proceedings commenced on May 10, 1961 (25 F.P.C. 942), with the institution by the Federal Power Commission of the *Southern Louisiana Area Rate Case* to establish just and reasonable rates for producer gas sales in the Southern Louisiana Area—an area which presently supplies one-third of the nation's interstate gas and has perhaps the highest potential for significant additions to that gas supply. Hearings and submission extended over more than seven years. Thirty-four thousand pages of testimony were recorded and 272 exhibits received. On September 25, 1968, the Commission issued its decision (40 F.P.C. 530) and, on March 20, 1969, a modified decision on rehearing (41 F.P.C. 301).

The decision was appealed to the Fifth Circuit.

In the meantime, a gas shortage had been developing throughout the nation and was becoming more apparent. Shortly before oral argument in the court of appeals the Commission released a Staff Report concluding that a demand exceeding supply was imminent.[1] Numerous public statements of the members of the Commission and other public bodies throughout the ensuing months confirmed this conclusion and emphasized that the situation was becoming critical.

On March 19, 1970, the court of appeals "affirmed" the Commission's decision, but with "serious misgivings." [2]

---

[1] Federal Power Commission Staff Report on National Gas Supply and Demand, October 1, 1969. See also the subsequent Staff Report No. 2 (1972) referred to in this Court's opinion in *Federal Power Commission* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 626 (1972).

[2] *Southern Louisiana Area Rate Cases (Austral Oil Co.* v. *Federal Power Commission)*, 428 F.2d 407, 439; on rehearing 444 F.2d 125 (5th Cir. 1970); *certiorari denied sub nom., Municipal Distributors Group* v. *Federal Power Commission*, 400 U.S. 950 (1970). This decision is sometimes referred to in the record and opinions herein as

Taking cognizance of the Staff Report and of the public statements by the members of the Commission, the court noted that "A serious shortage, in fact, may already be unavoidable. * * *"[3] The court pointed out that the Commission had made no attempt to determine whether the rates fixed in its decision were adequate to call forth sufficient gas supplies. It emphasized the seriousness of this deficiency, particularly in light of the fact that "* * * the Commission failed to approach supply or demand in either a semi-quantitative or qualitative way,"[4] notwithstanding evidence that the nation was faced with "* * * a severe gas shortage, with disastrous effects on consumers and the economy alike."[5] Because of these deficiencies in the Commission decision, the court accompanied its "affirmance" with directions on rehearing making it clear that under its "judgment" full power was restored to the Commission to make such changes in its order, as to both past and future rates, as it found to be in the public interest:

> "We wish to make crystal clear the authority of the Commission in this case to reopen *any* part of its order that circumstances require be reopened. Under section 19(b) of the Natural Gas Act, this Court has the broad remedial powers that inhere in a court of equity, and pursuant to our equitable powers we make it part of the remedy in this case that the authority of the Commission to reopen any part of its orders, including those affecting revenues from gas already delivered, is left intact. The Commission can make retrospective as well as prospective

---

"Austral" or "SoLa I." The instant decision is sometimes referred to as "Placid" or "SoLa II." Citations to the record herein are as described in the Brief for Petitioner, Mobil Oil Corporation (Mobil Br., p. 1).

[3] 428 F.2d at 437.

[4] 428 F.2d at 436.

[5] 428 F.2d at 435, n. 87.

adjustments in this case if it finds that it is in the public interest to do so.

"* * * it is our judgment that the Commission shall have the power and duty to remedy the situation by changing its orders" (emphasis by the court).[6]

Petitions for certiorari to review this decision of the Fifth Circuit were denied by this Court.[7]

Meanwhile, in March, 1969, the Commission had instituted proceedings to reconsider rates for the offshore portion of the Southern Louisiana Area.[8] Later in the year this proceeding had been expanded to include the entire area.[9] After the decision of the Court of Appeals, and in line with the authority granted it by that court, the Commission reopened the 1961 proceeding and consolidated it with the new proceeding.[10] In these combined proceedings settlement conferences instituted by the Presiding Examiner were joined in by all interested parties—producers, pipelines, distributors, state commissions, municipally owned utilities and the Commission Staff—in an effort to reach agreement on a proposal to submit to the Commission. A settlement was finally formulated which had the full support of the Commission's staff as being in the public interest (II A 130-132) and was agreed to by a large majority of all interests.[11]. The Commission

[6] 444 F.2d at 126-127.

[7] Nos. 669, 680-685, 691 and 692, October Term 1969, 400 U.S. 950.

[8] 41 F.P.C. 378; I A 2.

[9] 42 F.P.C. 1110; I A 73.

[10] 44 F.P.C. 1638; I A 352.

[11] The Commission pointed out (II A 589):

"15. In support of the settlement proposal are 32 major distribution companies representing 25 percent of the gas distribution operations in the United States, serving about 10.3

incorporated the settlement proposal in the record and invited evidence concerning it. The Commission recognized its duty to approve such a settlement proposal only if it found the terms to be in the public interest and supported by substantial evidence.[12] Accordingly, the Commission appraised the proposal in the light of the massive record it had compiled in the proceedings since 1961, including the additional year of hearings directed largely to the terms of the settlement proposal. The record compiled in the reopened proceedings contains over 7,800 pages of testimony, with 111 new exhibits.[13] This evidence included testimony concerning the gas shortage and estimates of the new supply needed to alleviate the problem (see II A 601-624); economic and cost evidence in support of rate levels needed to induce additional supply

---

million customers at retail; 55 gas distribution companies which supply gas service to more than 10 million customers; *all* interstate pipelines purchasing gas from the Southern Louisiana area; and 46 natural gas producers, comprising 80 percent of the total gas production flowing from the area."

[12] The Commission pointed out (II A 594):

"We have more than a settlement proposal before us. We have the entire record made in the original Southern Louisiana proceedings, plus the record opened with the institution of Docket No. AR69-1 and concluded after Docket No. AR61-2 was consolidated with it. The settlement proposal was obviously heavily influenced by the teachings of *Austral* [the decision of the Fifth Circuit on the first appeal], as the parties perceived those teachings, and so was the record made in conjunction with it. It is our duty to review that record and to make findings thereon, and to come to conclusions therefrom. Only if substantial evidence supports it can we approve the settlement proposal, and this means that we must analyze supply and demand, supply-cost relationships, and costing methodology. Rate design, incentives, refunds, and economic considerations, as the record permits insight into these matters must also be discussed."

[13] Many of these exhibits are comprehensive studies of the factual issues extending over hundreds of pages (e.g., Stanford Research Institute (Exhibit 4) reviewed by the Commission at II A 615).

(see II A 617-648); the amount of capital required to develop additional supply (see II A 623-630) and the need for a higher price to stimulate production of additional supply (see II A 617-624).

After a careful consideration and review of all the evidence, the Commission found the proposed settlement to be just and reasonable, supported by substantial evidence and within the zone of reasonableness. The ceiling rates, in the 1968 opinion, which had never gone into effect, were found to "perform no office" (II A 587). The Commission established rates for the future of 22.375 cents per Mcf for gas produced onshore and of 21.375 cents for gas produced offshore for all contracts dated prior to October 1, 1968 ("flowing gas") with an automatic increase of 0.5¢ on October 1, 1973 (II A 657). As an incentive for increasing the gas supply, the Commission also established increases in the rates for flowing gas of up to 1.5 cents per Mcf, contingent upon the industry finding and dedicating new gas reserves (II A 649, 658).[14] For contracts dated on or after October 1, 1968 ("new gas"), the rate was established at 26¢ for both onshore and offshore gas, with an automatice increase of 1.0¢ on October 1, 1974 (II A 657).

The Commission imposed a moratorium upon the filing of producer rate increases for flowing and new gas, respectively, until October 1, 1976 and October 1, 1977 (II A 651-652), established minimum pipeline rates for the transportation of certain liquids and liquefiable hydrocarbons (II A 688), and eliminated as to future dedica-

[14] The formula works thus: If, before October 1, 1977, the industry as a whole finds and dedicates to the interstate market new gas reserves in the Southern Louisiana Area of 7½ trillion cubic feet, the rate for flowing gas will escalate by ½ cent; if, prior to that time, such reserves equal 11¼ trillion cubic feet, the rate will increase by an additional ½ cent; if, prior to the same time, such reserves equal 15 trillion cubic feet, a final ½ cent escalation will become effective.

tions the price differential between casinghead gas and gas-well gas (II A 651).

With respect to refunds: The rates established by the Commission in its final order were higher than those which would have been established had its 1968 decision gone into effect.[15] Had the flowing gas rates approved by the Commission as just and reasonable been the sole basis for determining refunds, such refunds would have been substantially less than $150,000,000 (App. C, p. 43). However, under the proposed settlement, a "refund obligation" in the amount of $150,000,000, was provided for past deliveries, with a proviso that this refund obligation could be worked off by the commitment of additional gas reserves to the interstate market (II A 653). The Commission adopted this provision of the settlement proposal [16] and implemented it by approving, as a basis for refunds, rates for the 1961-1971 period which were below those found by the Commission in its final order to be just and reasonable (II A 652-3, 637).[17]

---

[15] The rates which would have been established had the 1968 order become effective ranged from 17 cents per Mcf to 20.0 cents per Mcf (App. C, p. 8). "App. C" herein refers to Appendix C to Mobil's Petition for a Writ of Certiorari in No. 73-437.

[16] The Commission's formula works thus (II A 666): Any company with a "refund obligation" to any natural gas pipeline company is allowed to reduce the refund obligation by one cent for each Mcf of new gas reserves committed in the Southern Louisiana Area to the interstate market during the period ending October 1, 1977. Any portion of the "refund" obligation" not so discharged is payable in cash with interest. The producer is required to commit at least 50 per cent of the new reserves to the purchaser to whom the refund would otherwise be payable (II A 666). The reserves committed to reduce the refund obligation may not be counted by the producer committing those reserves as a part of the industry reserves required to trigger the escalated prices for flowing gas referred to in footnote 14 above (II A 658).

[17] Cost studies in the record support all of these rates (IV A 585, IV A 601, V A 176e, V A 199e-200e, II A 643-648, II A 653-654).

[Footnote continued on page 9]

The court of appeals sustained the Commission in full (App. C, p. 58). It carefully reviewed and analyzed the evidence. It held that the Commission had diligently complied with this Court's decision in *Permian*[18] and with the teachings of the Fifth Circuit's earlier decision in this case. It found the Commission's order to be just and reasonable, in the public interest and supported by substantial evidence.

Specifically, the court of appeals reviewed the history of producer rate regulation and traced the long proceedings covering this particular area (App. C, pp. 6-15). It rejected categorically the "notion" that its earlier "affirmance" of the Commission's 1968 decision in any way impaired the Commission's power to alter or modify any of the provisions of such decision (App. C, p. 41). It examined the propriety of taking into consideration the settlement proposal, found this to be proper, and found that the Commission's final order was based on substantial independent evidence (App. C, pp. 20-23, 58). It reviewed the shortage of natural gas and the potential and future importance of the Southern Louisiana Area as a source of new supply (App. C, pp. 23-29), treated the rate structure, which included incentives for new production,

[17] [Continued]

The refund floors approved by the Commission were 20.625 cents per Mcf (onshore) and 19.625 (offshore) for the pre-1965 period; 21.25 cents (onshore) and 20.25 cents (offshore) for the period January 1, 1965 to September 30, 1968. These price levels were consistent with various company-wide settlements during these periods and the Commission's Statement of General Policy No. 61-1 (II A 652-653, n.138, n.139). For the period October 1, 1968 to January 1, 1971, the level was computed at 30.5 percent of the difference between the rates in effect prior to October 1, 1970 and the rates fixed by the Commission in its 1968 opinion. While this fraction was selected to make up the balance of the negotiated $150 million dollar refund figure, the Commission found that it provided an amount approximately equivalent to the other refund calculations and was just and reasonable (II A 654).

[18] *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

as an interrelated package (App. C, pp. 30-51), and concluded that the establishment of such rates was within the discretion of the Commission and was amply supported by the record. In addition, the court pointed out that the rates clearly fell "* * * within the range of cost estimates which the evidence discloses," quite apart from the non-cost (incentive) factors considered by the Commission (App. C, pp. 31, 39).[19] Among other things, the court said:

> "We may not as judges ignore what all others see. . . . Led by FPC, all others in the nation sense with a desperate urgency an energy supply shortage which can only be described as a crisis. . . . Thus, there is an increasing gap between supply and demand, and the consumers are feeling, or shortly will feel, the pinch" (App. C, pp. 23-24).
>
> * * * *
>
> "Fully aware of the critical gas supply shortage, and fully familiar with the factors which motivate producers to develop the resources to meet the demand, FPC approached its statutory task of establishing the 'just and reasonable' rates for the sale of natural gas at the well-head in SLA" (App. C, p. 29).
>
> * * * *
>
> "First it established rates for both flowing and new gas which FPC believed would encourage exploration and development of the rich natural gas resources of SLA. Second, it ordered a $150,000,000 refund in accordance with the terms of the settle-

[19] Four different cost studies were presented (II A 644). These studies estimated costs of production ranging from 18.2 cents (V A 239e) to 24.03 cents (V A 202e) per Mcf for gas flowing under contracts dated prior to October 1, 1968. With respect to gas sold under contracts dated on or after October 1, 1968, the cost estimates based on a 1969 test year ranged from 19.39 cents to 38.02 cents (II A 633). The rates ultimately fixed by the Commission, even including all incentive increments, were well within the range of cost estimates (see page 7, supra).

ment proposal, but—in order to protect the capital position of the producers—allowed the producers owing these refunds to work them off by the commitment of additional reserves to the jurisdictional market. And third, it provided for periodic and contingent escalations of these ceilings.

"We hold that this structure was amply supported by 'substantial evidence on the record as a whole'" (App. C, p. 30).

ARGUMENT

The decision below correctly holds that the Commission's order is supported by substantial evidence, is in the public interest, and was entered pursuant to the Commission's statutory powers as defined in *Permian*[20] and other controlling decisions of this Court.

The order of the Commission reflects a settlement proposal which was prepared after careful analysis by all parties of the enormous record in this case. The settlement conferences were convened by the Presiding Examiner after 9 years of proceedings, with a direction that the parties confer for the purpose of attempting to formulate a suitable settlement.[21] The Commission Staff participated throughout and fully supported the final result (I A 130-132). The final proposal was submitted by 32 gas distributing utilities representing 25 percent of all of the gas distribution operations in the United States, serving some 10 million consumers.[22] It was joined in by 55 gas distribution companies which serve a majority of the gas consumers along the Eastern Seaboard and account for over 11 percent of all gas distributed in the

---

[20] 390 U.S. 747.

[21] II A 671.

[22] United Distribution Companies, II A 669-671.

United States.[23] It was also joined in by every interstate pipeline purchasing gas from the Southern Louisiana area [24] and by 46 natural gas producers comprising more than 80 per cent of the total gas production in the area.[25] The public service commissions of 17 states were parties to the proceedings.[26] Three filed pleadings in support of the settlement.[27] Only The Public Service Commission of New York has objected.

While an agreement with respect to rates may not override the public interest or be binding upon dissenters, a proposed settlement with such broad support as the present one, arrived at under the auspices of the Commission and supported by its Staff, is certainly worthy of consideration and, to say the least, we submit, furnishes a substantial basis for a presumption that the rates proposed are not unjust and unreasonable.

The court below carefully defined the effect of the settlement proposal:

> "No one seriously doubts the power—indeed, the duty—of FPC to consider the terms of a proposed settlement which fails to receive unanimous support as a decision on the merits. We agree with the D.C.

---

[23] The Associated Gas Distributors Group (II A 589). The United and Associated distributor groups purchased 87 percent of the gas produced in Southern Louisiana which is sold in the New England, Appalachian, Great Lakes and Southeast Regions.

[24] II A 589.

[25] II A 589.

[26] Alabama, California, Connecticut, Georgia, Indiana, Kentucky, Maryland, Massachusetts, Michigan, Mississippi, Pennsylvania, New Jersey, New York, North Carolina, South Carolina, West Virginia, Wisconsin.

[27] Kentucky, Indiana, Mississippi. R 11982, 11986, 11989.

Circuit that even 'assuming that under the Commission's rules [a party's] rejection of the settlement rendered the proposal ineffective *as a settlement*, it could not, and we believe should not, have precluded the Commission from considering the proposal *on its merits*.'

* * * *

"As it should, FPC is employing its settlement power under the APA, 5 U.S.C.A. § 554(c), and its own rules 18 C.F.R. § 1.18(a), to further the resolution of area rate proceedings. If a proposal enjoys unanimous support from all of the immediate parties, it could certainly be adopted as a settlement agreement if approved in the general interest of the public. But even if there is a lack of unanimity, it may be adopted as a resolution *on the merits*, if FPC makes an independent finding supported by 'substantial evidence on the record as a whole' that the proposal will establish 'just and reasonable' rates for the area" (italics by the court) (App. C, pp. 20-22).[28]

As noted above, the Comission clearly perceived its appropriate function in connection with the settlement proposal, *supra*, p. 12, fn. 12). It arrived at its decision only after it was convinced by an independent examination of the record that the terms of the proposal were supported by substantial evidence and were in the public interest.

The contentions of the three petitioners in these consolidated cases relate to details which do not affect the substance of the Commission's order. Indeed, it is totally unrealistic to contend in today's market that prices for flowing gas of 21.375 and 22.375 cents per Mcf with incen-

[28] And see *Hugoton-Anadarko Area Rate Case*, 466 F.2d 974 (9 Cir. 1972); *Pennsylvania Gas & Water Co.* v. *Federal Power Commission*, 463 F.2d 1242 (D.C.Cir. 1972); *Cities of Lexington, etc., Ky.* v. *Federal Power Commission*, 295 F.2d 109 (4 Cir. 1961); cf. *Amoco Production Co.* v. *F.P.C.*, 465 F.2d 1350 (10 Cir. 1972).

tive escalations of up to 1½¢, and 26¢ per Mcf for new gas, are unjust and unreasonable.[29] There can be no question that if the order in this case were set aside and the cause remanded for further proceedings, the Commission would be compelled to enter an order fixing rates even higher than those fixed herein.[30] But in a rational administrative and judicial process finality must come at some time. These proceedings have consumed nearly thirteen years. They have received painstaking consideration by the Commission and an informed and conscientious review by the court of appeals. The challenged incentive provisions in the Commission's order have received, in principle, the express approval of this Court.[31] They clearly serve the public

---

[29] The court below pointed out that at the time of its opinion the Commission already had certified 62 separate sales to the interstate market at rates ranging from 26¢ to 40¢ per Mcf under Order No. 431 covering emergency purchases (App. C, p. 61, fn. 39). In testimony given on January 24, 1974 before the Energy Subcommittee of the Senate Finance Committee, Federal Energy Administrator, William E. Simon, testified that recent sales of natural gas in intrastate commerce have been made at prices up to $1.25 per Mcf. This Court pointed out in *Permian Basin Area Rate Cases*, 390 U.S. 747, 795 (1968), "We do not now hold . . . that field prices are without relevance to the Commission's calculation of just and reasonable rates under § 5(a)." Recent increases in costs are matters of judicial notice.

[30] In *Permian II*, Opinion No. 662, August 7, 1973, the Commission prescribed rates of 23¢ per Mcf for flowing gas and 35¢ per Mcf for new gas.

[31] In *Permian* this Court held (390 U.S. at 796-798):

> "The supply of gas-well gas is therefore relatively elastic, and its price can meaningfully be employed by the Commission to encourage exploration and production.
>
> * * * *
>
> "We have emphasized that courts are without authority to set aside any rate adopted by the Commission which is within a 'zone of reasonableness.' * * * The Commission may, within this zone, employ price functionally in order to achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price level for future programs of exploration and production. Nothing in the

interest at this time of gas supply crisis. The vital interests of the nation require the end of price uncertainty in this important producing region.[32] Nothing in the contentions advanced by petitioners herein warrants the setting aside of the Commission's decision.

1. MDG's contention that the Commission was without power to reopen the case.

MDG contends that the Commission had no power, after the first "affirmance" by the court of apeals, to reopen the case and establish rates higher than those fixed in its first decision. The contention is without merit. MDG argues as though the case presented the question whether the Commission has power, after an unqualified affirmance of a rate order by a court of appeals, thereafter retroactively to change the rates so made effective and so affirmed. No such question is presented on this record. There was no unqualified affirmance by the court of appeals. In its first decision, the court made it "crystal clear" that the Commission should have authority to reopen any part of its orders "including those affecting revenues from gas already delivered" (see pp. 4-5, *supra*).[33] The court's

---

purpose or history of the Act forbids the Commission to require different prices for different sales, even if the distinctions are unrelated to quality, if these arrangements are 'necessary or appropriate to carry out the provisions of this Act.' * * * We hold that the statutory 'just and reasonable' standard permits the Commission to require differences in price for simultaneous sales of gas of identical quality, if it has permissibly found that such differences will effectively serve the regulatory purposes contemplated by Congress."

[32] Nearly twenty years have elapsed since this Court in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954) held that producer rates are subject to FPC jurisdiction. Unless these proceedings are now brought to an end there will still be no final determination of the just and reasonable rates which producers may charge in this important area.

[33] The court emphatically reaffirmed that ruling in its present decision (App. C, pp. 30-31, 41-42).

authority to render such a decision, and the Commission's authority to act upon it, is unquestionable *Ford Motor Company* v. *National Labor Relations Board*, 305 U.S. 364, 373, 375 (1939); *Natural Gas Pipeline Co. of America* v. *Federal Power Commission*, 128 F.2d 481, 484 (7 Cir. 1942).

The 1968 Commission opinion and the rates proposed thereunder never became effective. The Commission's order continuously was stayed by orders of the Commission or the court until withdrawn by the Commission in its second opinion and order (II A 585). The Commission has the power to change its administrative orders which have not become final because of court review *United Gas Improvement Company* v. *Callery Properties, Inc.*, 382 U.S. 223, 229 (1965); *S.E.C.* v. *Chenery Corporation*, 332 U.S. 194, 200-201(1947); *Hunt Oil Company* v. *F.P.C.*, 334 F.2d 474 (5 Cir. 1964).

2. Petitioners' contentions that the $150 million refund is not supported by substantial evidence.

All three petitioners contend that no evidence supports the Commission's figure of $150 million as a refund liability. The "short answer", as the court below pointed out, is that, under the evidence as to costs in this record, the Commission fixed 22.375 cents per Mcf as a just and reasonable rate for flowing gas (1¢ less for offshore), with the automatic and contingent escalations provided in the order (II A 648). Had refunds been computed on these cost-supported rates their total amount would have been less than the $150 million ordered by the Commission. Further, the evidence in the record clearly would support a finding by the Commission that no refunds at all should be required. There is record demonstration that the revenues received by the producers for gas production from the Southern Louisiana Area were less than the costs incurred in finding and producing this gas on

an industry-wide basis (Exhibit 91, V A 236e; Exhibit 92, V A 238e), a ground which this Court in *Wisconsin* v. *F.P.C.*, 373 U.S. 194 (1963) found sufficient to excuse refunds. The Commission's Staff witness reached this conclusion and recommended that no refunds be required (IV A 686, 693). The $150 million refund order was simply the implementation by the Commission of the settlement agreement (II A 652), after a finding that the rates upon which the earlier and larger refunds had been computed "did not afford an adequate return" (II A 653). The payment of the agreed refund rather than no refund at all in no way prejudices any interests represented by New York Public Service Commission or MDG. And the only "injury" suffered by Mobil is the realization that it made an improvident bargain when it settled its refund liabilities before final decision (see pp. 22 to 25, *infra*).

As the court below pointed out, the Commission is not required to order refunds and is empowered to structure any refund order in a manner which "will fairly balance the public interest" (App. C, pp. 43-44).[34] In the light of the foregoing, it cannot be said that the Commission's refund order constituted an abuse of discretion.

---

[34] Arguments similar to those made by petitioners were rejected in the *Hugoton-Anadarko Area Rate Case*, supra:

> "As the Commission points out, section 4(e) of the Act, 15 U.S.C. § 717c(e), does not require refunds where unlawful rates have been collected in prior years, but leaves this to the discretion of the Commission. The view that the Commission's refund power is discretionary has support in the court decisions. In *Permian*, 390 U.S. at 767, 88 S.Ct. 1344, 20 L.Ed. 2d 312, the Supreme Court made it clear that the Commission is free, within the limits imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests. In exercising this discretion it is 'the duty of the Commission to look at "the backdrop of the practical consequences . . ." ' of its refund order" (466 F.2d at 990-991).

Finally, and in any event, as pointed out above, cost studies in the record fully support each of the rates upon which the refunds were based (*supra*, p. 8, fn. 17).

3. Petitioners' contentions that the rates fixed by the Commission for flowing gas and new gas are unsupported by substantial evidence.

Mobil contends that the rates fixed both for flowing gas and for new gas are too low. New York and MDG are content with the rates fixed for new gas but argue that the rates for flowing gas are too high. Mobil suggests that the Commission was influenced to fix lower rates than were reasonable for flowing gas by its accompanying reduction in the refund liability (Br. pp. 48-50). MDG and New York argue that the Commission should have adhered to cost estimates accepted in its first decision (Br., N.Y. pp. 26-34, MDG pp. 23-33). None of these contentions has merit. Cost studies in the record support the rates fixed by the Commission.[35] Petitioners, on the basis of these studies, might have selected a different figure, Mobil a higher one, New York and MDG a lower one. But this is the function of the Commission. Its finding that the rate in between the two extremes is just and reasonable is supported by the evidence and must, therefore, be upheld.

All petitioners level particular attack upon that portion of the Commission's order which provides incentive increments in the price of flowing gas. The criticisms range from MDG's argument that no basis can ever exist for incentive increments to flowing gas prices because new exploration is generated only by the prices for new gas (MDG Br., pp, 34-35) and because in any event an incentive increment is "contrary to traditional utility con-

---

[35] Testimony in the record before the Commission rendered its 1968 decision would support a rate of 24¢-25¢ per Mcf for flowing gas (R. 3049-3059).

cepts" which require stockholders and not consumers to supply needed capital (MDG Br., pp. 36-37) to the contention that incentive increments on flowing gas prices may be permissible but the amounts fixed by the Commission here are without evidentiary support (New York Br. pp. 35-40).

Again these contentions lack merit.

The view that traditional concepts of utility regulation must govern producer ratemaking in the gas industry has long been discredited.[36] Indeed, it was upon this rock that early regulation of gas producers foundered.[37] Nor is there merit in the contention that the Commission was without power to encourage new supplies of gas by incentive increments to flowing gas prices. As the court below pointed out (App. C, p. 32) the Commission was not required to close its eyes to the fact that an increased rate for flowing gas would generate internal capital available for expenditure in the search for new gas. And the inclusion by the Commission of incentive factors in the

---

[36] In *Permian* this Court said (390 U.S. 756-757):

> "Producers of natural gas cannot usefully be classed as public utilities. They enjoy no franchises or guaranteed areas of service. They are intensely competitive vendors of a wasting commodity they have acquired only by costly and often unrewarded search. Their unit costs may rise or decline with the vagaries of fortune. The value to the public of the services they perform is measured by the quantity and character of the natural gas they produce, and not by the resources they have expended in its search; the Commission and the consumer alike are concerned principally with 'what [the producer] gets out of the ground, not * * * what he puts into it * * *.' * * * The exploration for and the production of natural gas are thus 'more erratic and irregular and unpredictable in relation to investment than any phase of any other utility business.'"

[37] *Permian*, at page 758, et seq. And see the opinion of the court below (App. C, p. 6, et seq.)

rate structure, in recognition of this fact, has the approval of this Court.[38]

New York and MDG criticize the Commission for fixing 7.5, 11.25 and 15 trillion cubic feet of new reserves as the respective levels at which the incremental increases of ½ cent become effective (New York Br., pp. 35-37; MDG Br., pp. 51-52). They argue that the level of additions to new reserves in the past suggest that the incremental levels should be higher if they are to be meaningful. But such matters are clearly within the discretion of the Commission.

Petitioners also urge that the evidence does not support a finding that the increments in price will elicit the anticipated additional supply. The Commission had before it extensive testimony concerning the gas shortage and estimates of the new supply needed to alleviate the problem (see II A 601-624); economic and cost evidence in support of rate levels needed to induce additional supply (see II A 617-648); the amount of capital required to develop additional supply (see II A 623-630) and the need for a higher price to stimulate production of additional supply (see II A 617-624). Upon the basis of this testimony the Commission reasonably could conclude that

---

[38] See p. 14, *supra*, fn. 31. And the the opinion of Mr. Justice Jackson in *Colorado Interstate Gas Co.* v. *FPC* (1945) 324 U.S. 581, 612:

> "Far-sighted gas-rate regulation will concern itself with the present and future, rather than with the past, as the rate-base formula does. It will take account of conditions and trends at the source of the supply being regulated. It will use price as a tool to bring goods to market—to obtain for the public service the needed amount of gas. * * * if the supply is not too plentiful and the price is not a sufficient incentive to exploit it and fails to bring forth the quantity needed, the price is unwisely low, even if it does square perfectly with somebody's idea of return on a 'rate base.' The problem, of course, is to know what price level will be adequate to perform this economic function."

the increments would indeed provide an incentive for the exploration and development of gas reserves in the Southern Louisiana area. And the same testimony supplied the Commission with a logical range of alternatives for selecting the increments and the levels at which they would become effective.

It is true that no witness quantified the specific amount of additional supply which a given increase would induce. Such testimony is unobtainable. This was recognized and said by the Court below:

> "* * * With this many variables, it is impossible, with any degree of precision likely to satisfy the momentary opponent's fetish for quantification to determine the likely quantitative effect on supply of a change in rate ceiling * * *" (App. C, 36-37).

To require the Comission to take testimony no one can give, in order to support a finding which cannot possibly be made, is simply to say that the Commission under no circumstances may take into account any incentive factor in formulating a rate structure. This, of course, is contrary to the specific teachings of the decisions of this Court.[39] Those decisions emphasize that "the Commission's broad responsibilities * * * demand a generous construction of its statutory authority"; that it is "not bound to the service of any single regulatory formula"; that it is permitted "to make the pragmatic adjustments which may be called for by particular circumstances"; that the "breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties"; that "the courts are without authority to set aside any rate adopted by the Commission which is within a "zone of reasonableness," and that within that zone the Com-

---

[39] See p. 19, fn. 36, *supra*.

mission may "employ price functionally in order to achieve relevant regulatory purposes." [40] Here, after a consideration of the extensive evidence relating to the gas shortage and the influence of price upon supply, the Commission established the modest price incentives in the rate structure which are to become effective only upon the dedication of substantial new supplies of gas to the jurisdictional market. It is clear, we submit, that this action falls within the zone of reasonableness within which the Commission may function in its regulatory capacity.[41] And this is particularly true in this case where, as the court below noted, all of the rates fixed by the Commission, including the non-cost factors, clearly fall "within the range of cost estimates which the evidence discloses" (App. C., pp. 31, 39).

4. Petitioners' contentions that the rates fixed by the Commission are unduly discriminatory.

A. *The incentive provisions in the refund order.*

All three petitioners join in attacks against the provisions in the refund order which permit refund obligations to be worked off by the dedication of new reserves. Mobil is concerned chiefly with a claimed discrimination among producers; New York and MDG, with alleged discrimination against purchasers.

Mobil's complaint arises from the fact that it discharged most of its refund liability before the final decision below. It now feels aggrieved because other parties (1) may work off their "refund' obligations by discovering and contributing new reserves to the interstate mar-

---

[40] *Permian*, pp. 776-777, 790, 797.

[41] To the extent that the language of the court in *Public Service Com'n., State of N. Y.* v. *Federal Power Com'n.*, (D.C. Cir. 1973), 487 F.2d 1043, 1071, 1090, requires quantification by the Commission it is, we submit, clearly erroneous.

ket instead of by paying cash as Mobil did, and (2) are not permitted to count the new reserves charged against refunds as a part of the industry reserves which will trigger the escalated prices for flowing gas, thus requiring Mobil to contribute a disproportionate share to the industry reserves which will trigger the escalated prices. Mobil sees a particular vice in the fact that the $150,000,000 refund liability is owed by a "handful of producers * * * who have collected the highest rates in the past, and [the work-off provision, therefore] is unduly discriminatory against other producers who made refunds in the past, reduced their rates, and generally adhered to Commission 'guidelines' in filing rate increases between 1960 and 1970" (Mobil Br., p. 26). Mobil classes itself with the "good producers" who paid refunds and lowered rates but does not explain the background, which is as follows:

Early in the course of these proceedings, Mobil decided to settle, on a company-wide basis for all rate areas, a major portion of the refund liability which it might be adjudged to have at the conclusion of the various area rate proceedings. Mobil's settlement worked out to a payment of 45% of its refund exposure (31 F.P.C. 1101, 1105). A part of this settlement included an agreement by Mobil to reduce its rates for the future. Twenty-two other producers entered into similar settlements.[42] The conduct of the "good producers" described in the above quotation from Mobil's brief is simply a description of the terms of the settlements. The "bad producers" are those who insisted that their rates were reasonable and decided to press this claim to final judgment. Mobil alone, of the many producers who entered into the settlement agree-

[42] A list of the settling producers, with citations to the reported settlements, appears in the opinion of the court below (App. C, pp. 46-47, n. 31). No producer other than Mobil complains in this Court of discrimination.

ments, now considers itself aggrieved by the "undue discrimination" arising from the fact that the final order of the Commission permits the producers who did not settle to work off their refund obligations by contributing reserves instead of paying cash. But this "discrimination" arises solely from Mobil's voluntary settlement. Under its settlement Mobil was allowed to retain $14.6 million dollars of the moneys it had collected subject to refund, or approximately 55 percent of its total refund exposure up to January 1, 1967 (see 31 F.P.C. 1101, 1105).[43] It has no basis to complain now because it voluntarily negotiated a settlement at rates which were different than those finally established. As the Commission said in answering Mobil's contention (II A 644):

> "Parties who enter into settlements or those who refuse to do so, always run the risk that the ultimate Commission determination may be higher or lower than the settlement levels."

And the court of appeals pointed out (App. C, p. 47, n. 31):

> "If the SoLa II rates were lower than those established in these agreements, the private settlements would have been worthwhile. As it turns out, FPC was more generous in SoLa II than was anticipated. But this clearly furnishes no basis for attack."

The arguments of New York and MDG place emphasis upon an alleged discrimination as to purchasers. The contention is that the refund order is discriminatory because it permits producers to work off refunds by dedi-

---

[43] By comparison with Mobil's 55% settlement, the three companies Mobil particularly points to as "bad producers"—Shell, California and Superior—had their refund obligations reduced by the Commission's final decision by 59.7 percent, 54.5 percent and 52 percent, respectively. Mobil's refund obligations remaining after its settlement were reduced by the Commission's final decision from $6.4 million to $1.7 million or by 73% (Exh. No. 104, V A 268e).

cating 50 percent, rather than 100 percent, of the new reserves to purchasers other than those to whom the refunds would otherwise be payable. The court below held that it was within the realm of administrative discretion, under the teachings of *Permian*, to treat the refund benefit on an area-wide basis. The record shows that two-thirds of the refund obligations are owed to 3 of the 14 pipeline companies serving the Southern Louisiana Area (V A 281e). Under the discretionary power of the Commission to formulate rates on an area-wide basis it cannot be contended, we submit, that the Commission abused its discretion in guaranteeing that 50 percent of the new reserves must be sold to these three companies but that other purchasers may share in the balance. No one's money is given away for, by hypothesis, what might have been a money obligation has been converted to an obligation, in the interest of the public generally, to explore for and produce new gas anywhere within the area. The dedication of 50 percent of the new reserves to the three companies, particularly in today's market, may well exceed in benefit the amount of the refunds. But in any event the purchasing companies do not complain. Nor does New York or MDG show that the consumers served by pipelines in the area of either will suffer.

Finally, petitioners contend that the benefits of the work-off provision of the refund order accrue entirely to present producers in the Southern Louisiana Area, thereby "imperiling the entry of new producer entrants and giving a competitive advantage to producers who had charged the most unreasonable rates in the past" (MDG Br., p. 47). The court below (answering this attack upon the contingent escalation provisions of the rate order as well as the refund work-offs) pointed out (App. C, p. 51):

> "And for that unnamed new market entrant for whom much concern is expressed, we fail to see why

he would be in the least bit dissuaded from committing new reserves at 26¢/Mcf by the fact that it might allow some of his competitors to raise their 22.375¢/Mcf flowing gas price by a half-penny".

B. *The incentive provisions in the rate structure.*

Petitioners also charge that the ½ cent incentive increases on flowing gas are discriminatory. The argument is that "since the benefits of the Commission's scheme will abound [sic] solely to the large producers with established positions in the Southern Louisiana area, it will severely discriminate against new entrants into the market" (New York Br., p. 37).[44] Also, "producers with large flowing gas sales in the area, can withdraw from the gas production business entirely and still secure the benefits of the Commission's largesse" (New York Br., p. 39). But the Commission was not required to act in the light of a wholly unreasonable and unsupported suggestion that producers of gas in the Southern Louisiana area will abandon their normal business of exploring for and developing new gas reserves simply because they might enjoy a possible ½ cent increase in their prices for flowing gas if other producers go ahead and contribute substantial additional reserves. The escalation in price operates equally upon all producers as an incentive to contribute to the total reserves which will trigger the increased price. The fact that some producers (and certainly these would not be the large producers as New York suggests) may not invest additional capital, or the fact that other producers may do so but be unsuccessful and thus contribute no new reserves, are but facets of areawide pricing which need take into consideration only just and reasonable overall incentive provisions in the price.[45]

---

[44] This point was answered by the court below as quoted in the text just above.

[45] *Permian* at 797-798.

5. Mobil's Contentions as to Royalties and Moratoria.

Mobil, anticipating higher royalty costs, criticizes the Commission for failing to provide automatic adjustments in area rates to compensate for such expected costs (Mobil Br., pp. 71-75). The court below answered (App. C, p. 56):

> "But we are not willing to alter or stay the implementation of area wide rates for the entire industry merely on the basis of what *might* happen to *some* producers' costs *if* this statement of the law prevails.
>
> "If, as subsequent events develop, the producers are put in a bind by their royalty obligations, they may certainly petition FPC for individualized relief" (emphasis by the court).

A like ruling was made with respect to Mobil's objections to the moratoria fixed by the Commission (App. C, p. 52):

> ". . . there are several alternative methods by which a single aggrieved producer may establish higher rates as his circumstances warrant. . . . Thus, the system is so structured that FPC can retain industry and area wide rate stability for a period of at least five years while simultaneously protecting the financial integrity of the individual producer. And if the change in circumstances is so widespread that the area rate is no longer economically feasible as set, FPC has the power to lift its moratorium or establish new area rates, or both."

6. Casinghead Gas.

Casinghead gas has traditionally been treated as a by-product of oil and, accordingly, costed and priced lower than gas-well gas. In this and contemporaneous proceedings the Commission has eliminated this distinction so far as new dedications are concerned. The court below

found that several considerations support the Commission's action: (1) "the exigencies of administration demand the smallest possible number of separate area rates" (quoting *Permian* at page 761); (2) there is a serious problem of allocating exploration and development expenses between oil and gas; (3) a lower price on casinghead gas invites diversion to the intrastate market, and (4) an economically unfeasible price on casinghead gas encourages its flaring rather than marketing.[46]

New York alone objects to this portion of the Commission's order (New York Br., pp. 43-45). Its objections, we submit, are unsubstantial.

7. Pipeline Transportation.

The Commission's order (II A 688-689), affirmed by the court of appeals (App. C, p. 57), established minimum rates to be paid by producers to pipelines for transportation of liquids and liquefiable hydrocarbons.[47]

Mobil contends that these minimum rates are not supported by substantial evidence. To the contrary the Commission's finding is supported by the testimony of two qualified witnesses (IV A 605-616).

---

[46] In its opinion on rehearing the Commission stated (II A 871):

"We note again, that the Btu content of casinghead and gas-well gas is about the same, and the record shows that substantial volumes of casinghead gas are being flared in Southern Louisiana—reason in itself for eliminating the price discrimination."

[47] Since the court below rendered its decision the court of appeals for the District of Columbia Circuit has held that the Commission has no jurisdiction over rates for the transportation of liquids (*Mobil Oil Corporation* v. *FPC*, 483 F.2d 1238 (D.C. Cir., 1973). This jurisdictional question was not treated in the decision of the court below (App. C, p. 57).

CONCLUSION

For the foregoing reasons the decision of the court of appeals should be affirmed.

Respectfully submitted,

FRANCIS R. KIRKHAM
JAMES B. ATKIN
WOOLLEN WALSHE
DAVID B. WARD
JUSTIN R. WOLF

Attorneys for
The California Company,
A Division of Chevron Oil
Company

CERTIFICATE OF SERVICE

The within Brief of Respondent, The California Company, a Division of Chevron Oil Company, has been served in accordance with Rule 33 by mailing three (3) copies thereof, postage prepaid, to all counsel of record and to the Solicitor General of the United States this 29th day of March, 1974.

/s/ Justin R. Wolf
JUSTIN R. WOLF

An Attorney for Respondents